

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-13 ISO-00 SP-02 USIA-15 AID-05

EB-07 NSC-05 CIEP-02 SS-15 STR-04 OMB-01 CEA-01

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SIL-01 L-03 H-02 DODE-00 PA-02 PRS-01 EURE-00 /133 W

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O R 041728Z AUG 76

FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

SECSTATE WASHDC 4256

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY NEW DELHI

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USDEL MTN GENEVA

USDOC WASHDC

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DEPARTMENT PASS FRB

TREASURY FOR DONALD SYVRUD, OASIA

E.O. 11652: N/A

TAGS: ECON, UK

SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD JULY 29 - AUG-
UST 4, 1976

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SUMMARY: IN THE LAST FEW DAYS BEFORE THE TWO-MONTH PAR-

LIAMENTARY RECESS' THE GOVERNMENT MAINTAINED COMMONS SUPPORT FOR ITS ANNOUNCED PUBLIC EXPENDITURE CUTS AND PUT FORWARD YET ANOTHER PROGRAM OF MEASURES DESIGNED TO AID SOME OF THE RECORD NUMBER OF UNEMPLOYED SCHOOL LEAVERS. BOTH THE QUARTERLY INDUSTRIAL TRENDS SURVEY OF THE CONFEDERATION OF BRITISH INDUSTRY AND THE MONTHLY FINANCIAL TIMES BUSINESS OPINION SURVEY FOUND THE UK ECONOMY IN THE EARLY STAGE OF A PRONOUNCED ECONOMIC RECOVERY. U.K. RESERVES ROSE BY 58 MILLION POUNDS IN JULY REFLECTING A RELATIVELY QUIET AND STABLE PERIOD FOR STERLING. END SUMMARY.

1. PUBLIC SPENDING PACKAGE JUSTIFIED. IN THE PARLIAMENTARY DEBATE ON THE PUBLIC EXPENDITURE CUTS (SEE LONDON 12080) THE CHANCELLOR FLESHED OUT SOME OF THE POINTS BEHIND HIS INITIAL ECONOMIC RATIONALE. WITH REGARD TO THE PAYROLL TAX HE SAID THAT

- A. ITS IMPACT WOULD BE SPREAD WIDELY AND WOULD HAVE "A RELATIVELY DELAYED EFFECT ON THE DEMAND FOR REAL RESOURCES.
- B. THE TAX WOULD ADD ABOUT 1 PERCENT TO MANUFACTURERS' COSTS.

COMMENTING ON THE SKEPTICISM OVER THE FORECAST INCREASE OF 60,000 IN THE NUMBERS LOSING THEIR JOBS AS A RESULT OF THE PACKAGE, THE CHANCELLOR ADMITTED THAT WHILE HE DIDN'T BELIEVE THE UNEMPLOYMENT IMPACT WAS UNDERSTATED, IT COULD BE BIGGER. HOWEVER, OVERALL LEVELS OF UNEMPLOYMENT WOULD BE LOWER BY THAT TIME. FINALLY THE CHANCELLOR REPEATED HIS BELIEF THAT HIS PACKAGE WAS DESIGNED TO DO THE LEAST POSSIBLE DAMAGE TO INDUSTRIAL OUTPUT AND COMPANY PROFITS.

2. NEW UNEMPLOYMENT PACKAGE ANNOUNCED. WITH 209,000 SCHOOL LEAVERS ALREADY ON THE UNEMPLOYMENT ROLLS AND MORE EXPECTED THIS MONTH. EMPLOYMENT SECRETARY ALBERT BOOTH ANNOUNCED A 24.4 MILLION POUND PROGRAM AIMED AT CREATING JOB OPPORTUNITIES FOR THIS GROUP. THE PROGRAM EXTENDS SOME OF THE MEASURES ANNOUNCED A YEAR AGO UNDER SIMILAR CIRCUMSTANCES. IT IS INTENDED TO PROVIDE TRAINING OR WORK FOR 60,000 TEENAGERS AND INCLUDES THREE SPECIFIC ACTIONS:

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WORK EXPERIENCE -- SOME 30,000 SCHOOL LEAVERS AGED 16-18 WILL BE PAID 15 POUNDS PER WEEK BY THE GOVERNMENT. THEY WILL BE PLACED IN PARTICIPATING FIRMS FOR A SIX-MONTH PERIOD WHERE THEY WOULD BE EXPOSED TO THE EXPERIENCE. DISCIPLINE AND ROUTINES OF THE FACTORY OR THE OFFICE. AT THE END OF THAT TIME. THEY WOULD BE BETTER PREPARED TO SEEK A PERMANENT JOB. COST. 19 MILLION POUNDS.

THE 5 POUND A WEEK RECRUITMENT SUBSIDY FOR
SCHOOL LEAVERS INSTITUTED LAST YEAR WILL BE IN-
CREASED TO 10 POUNDS. IT WILL BE PAID TO EMPLOY-
ERS RECRUITING PEOPLE UNDER 20 WHO HAVE BEEN UN-
EMPLOYED FOR AT LEAST 6 MONTHS. COST, 5.4 MIL-
LION POUNDS.
THE MANPOWER SERVICES COMMISSION WILL CREATE
3,000 ADDITIONAL JOB TRAINING PLACES FOR YOUNG
PEOPLE WITHIN ITS EXISTING BUDGET.
IN LINE WITH PREVIOUS PACKAGES OF THIS KIND, THE SPECIFIC
MEASURES ARE LITTLE MORE THAN COSMETIC. IN ECONOMIC
TERMS, THEY WILL REDUCE THE PREVALING
MINIMUM WAGE AS PERCEIVED BY EMPLOYERS. SINCE THE

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FM AMEMBASSY LONDON

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SECSTATE WASHDC 4257

INFO AMEMBASSY BERN

AMEMBASSY BONN

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MINIMUM WAGE CANNOT BE CUT ON AN ACROSS THE BOARD BASIS AND THE GOVERNMENT DOES NOT HAVE THE RESOURCES TO SUBSIDIZE THE WAGES FOR ALL THOSE UNDER 20 WHO ARE LOOKING FOR WORK, THE PRESENT PACKAGE WILL DO LITTLE TO GET AT THE CORE OF THE PROBLEM.

3. OFFICIAL RESERVES. U.K. OFFICIAL RESERVES ROSE BY
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\$58 MILLION IN JULY TO A LEVEL OF \$5,370 MILLION. THIS FIGURE INCLUDES ACCRUALS OF FOREIGN CURRENCY BORROWING BY THE PUBLIC SECTOR UNDER THE EXCHANGE COVER SCHEME OF \$326 MILLION. IDENTIFIED PUBLIC SECTOR BORROWINGS DURING JULY WERE: \$150 MILLION BY THE NATIONAL WATER COUNCIL; \$40 MILLION BY THE POST OFFICE; \$50 MILLION BY THE NATIONAL COAL BOARD; AND \$15 MILLION BY BRITISH GAS. PUBLIC SECTOR FOREIGN CURRENCY BORROWINGS HAVE AVERAGED ABOUT \$300 MILLION IN RECENT MONTHS, AND THERE ARE REPORTS THAT THIS LEVEL MIGHT BE MAINTAINED FOR SEVERAL MONTHS. SOME OBSERVERS SPECULATE THAT DRAWING ON THE \$5.3 BILLION STAND-BY CREDIT MAY HAVE BEEN \$1 BILLION OR LESS IN JUNE, FOLLOWING AN OFFICIAL ANNOUNCEMENT THAT THERE HAD BEEN NO DRAWING IN JULY, AND THE NEED FOR AN ADDITIONAL IMF BORROWING MIGHT THEREFORE NOT ARISE.

4. CBI BUSINESS SURVEY. THE LATEST QUARTERLY INDUSTRIAL TRENDS SURVEY PUBLISHED BY THE CONFEDERATION OF BRITISH INDUSTRY (CBI) SHOWS A DEGREE OF BUSINESS OPTIMISM MORE WIDESPREAD THAN AT ANY TIME SINCE 1973. CBI SUMMARIZES THE MAIN RESULTS OF THE SURVEY AS FOLLOWS:

- A. BUSINESS CONFIDENCE IS RECOVERING AND IS WELL-SPREAD.
- B. THE LEVEL OF ACTIVITY IN MANUFACTURING INDUSTRY AS A WHOLE IS IMPROVING AS TRENDS IN NEW ORDERS AND OUTPUT STRENGTHEN.
- C. THE RECOVERY IS NOT FAR ADVANCED: BELOW-CAPACITY WORKING CONTINUES FOR ALMOST THREE-QUARTERS OF ALL FIRMS IN MANUFACTURING INDUSTRY AND SHORTAGE OF ORDERS OR SALES IS LIKELY TO LIMIT PRODUCTION FOR A SIMILAR PROPORTION OVER THE COMING MONTHS.
- D. THE PERIOD OF RAPID REDUCTION IN NUMBERS EMPLOYED AND IN STOCKS HAS ENDED.

- E. TRENDS IN EXPORTS ARE AGAIN ENCOURAGING.
- F. MANUFACTURING INVESTMENT IS NOW PROBABLY BEGINNING TO INCREASE AGAIN; AND COULD RISE QUITE RAPIDLY THROUGH 1977.

UNDERLINING THE MORE OPTIMISTIC VIEW TAKEN BY INDUSTRIALISTS IS THE FACT THAT IN ONLY 3 OF 33 SECTORS WAS THERE A BALANCE OF NEGATIVE VIEWS COMPARED WITH A NEGATIVE BALANCE IN ALL 33 SECTORS 12 MONTHS AGO.

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THERE IS VERY LITTLE INDICATION OF ANY SUPPLY SIDE BOTTLENECKS. HOWEVER, CBI IS QUICK TO POINT OUT THAT THE SURVEY COVERS ONLY THE NEXT 4 MONTHS AND THE PICTURE COULD CHANGE ABRUPTLY. WITH REGARD TO INVESTMENT IN MANUFACTURING INDUSTRY, THE SURVEY INDICATES A POTENTIAL INCREASE OF 10 TO 15 PERCENT IN VOLUME OVER THE 12 MONTHS ENDING IN SEPTEMBER 1977. A VOLUME INCREASE OF 20 TO 25 PERCENT WAS POSSIBLE (BEFORE TAKING ACCOUNT OF THE RECENTLY ANNOUNCED CUTS IN PUBLIC EXPENDITURE) BETWEEN THE FOURTH QUARTER OF 1976 AND 1977 BRINGING MANUFACTURING INVESTMENT BACK TO 1970 LEVELS.

IN REVIEWING THE POLICY IMPLICATIONS OF THE SURVEY, CBI POINTS OUT THAT

- A. INCREASED U.K. EXPORT COMPETITIVENESS IS BEING USED TO IMPROVE THE RATE OF RETURN ON FOREIGN SALES. HOWEVER, SMALLER FIRMS HAVE NOT YET TAKEN FULL ADVANTAGE OF THE OPPORTUNITY TO INCREASE SALES VOLUME OR RAISE STERLING PRICES.
- B. THE INTENTION TO INCREASE INVESTMENT IS AN ACT OF FAITH BY BUSINESS BASED ON THE BELIEF THAT

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SIL-01 L-03 H-02 DODE-00 PA-02 PRS-01 EURE-00 /133 W

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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

SECSTATE WASHDC 4258

INFO AMEMBASSY BERN

AMEMBASSY BONN

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"REFERENCES BY THE GOVERNMENT TO THE NEED TO RE-
STORE A HEALTHY AND PROFITABLE PRIVATE SECTOR ARE
REAL."

C. THE RECENTLY ANNOUNCED CUTS IN PUBLIC SPENDING
ARE WELCOME BUT THEIR EMPHASIS IS WRONG.

D. THE INCREASED PAYROLL TAX IS "ILL-CONSIDERED."

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5. FINANCIAL TIMES BUSINESS SURVEY. THE FINANCIAL TIMES
BUSINESS OPINION SURVEY FOR JULY SHOWS LESS BULLISHNESS
ON THE GENERAL BUSINESS SITUATION THAN WAS THE CASE EARLI-
ER IN THE YEAR. WHILE OPTIMISTS CONTINUED TO OUTNUMBER
PESSIMISTS BY A WIDE MARGIN, THE GAP NARROWED SHARPLY IN
JUNE AS MORE REpondENTS DECLARED THEMSELVES NEUTRAL ABOUT
THEIR FIRMS' PROSPECTS.

PERCENT

	JULY	JUNE	MAY	APRIL	
MORE OPTIMISTIC		39	47	51	59
NEUTRAL		53	49	45	34
MORE PESSIMISTIC		8	4	4	7

EXPORT PROSPECTS AND THE TREND IN NEW ORDERS REMAIN STRONG WITH 86 PERCENT OF FIRMS ANTICIPATING HIGHER EXPORTS AND 42 PERCENT REPORTING A RISING TREND IN NEW ORDERS COMPARED WITH 16 PERCENT OF FIRMS EXPERIENCING A DECLINING TREND. IN LINE WITH THESE FIGURES, 43 PERCENT OF RESPONDENTS EXPECT THEIR SALES TO RISE BY AT LEAST 5 PERCENT OVER THE 12 MONTHS WHILE 46 PERCENT EXPECT NO CHANGE. THERE HAS BEEN LITTLE CHANGE IN THE SALES OUTLOOK SINCE THE APRIL SURVEY.

THE PATTERN OF ANTICIPATED INVENTORY BEHAVIOR HAS ALSO REMAINED RELATIVELY CONSTANT. WITH REGARD TO RAW MATERIALS AND COMPONENTS' 37 PERCENT OF FIRMS EXPECT A RISE IN THEIR STOCK LEVELS OVER THE NEXT YEAR, 48 PERCENT BELIEVE THERE WILL BE NO CHANGE, WHILE JUST 7 PERCENT ANTICIPATE A DECLINE. THE COMPARABLE JUNE FIGURES WERE 36, 47 AND 9 PERCENT. TURNING TO INVENTORIES OF FINISHED GOODS, 22 PERCENT OF RESPONDENTS LOOKED FOR A RISE OVER THE NEXT YEAR, 48 PERCENT FELT THERE WOULD BE NO CHANGE AND AGAIN 7 PERCENT LOOK FOR A DROP IN INVENTORY LEVELS. THESE RESULTS CONFIRM THAT DESTOCKING HAS ENDED, BUT DO NOT FORESHADOW A MASSIVE PROGRAM OF INVENTORY INVESTMENT.

ON THE SUPPLY SIDE, THERE DOES NOT APPEAR TO BE ANY SIGN OF SHORTAGES OF LABOR, NEW MATERIALS, PRODUCTION CAPACITY, MANAGERIAL STAFF OR FINANCE WHICH WOULD SLOW THE PACE OF THE RECOVERY. JUST 12 PERCENT OF FIRMS REPORT THAT THEY ARE OPERATING ABOVE TARGET CAPACITY WHILE 38 PERCENT ARE STILL BELOW THAT POINT. THE MAIN IMPEDIMENTS TO PRODUCTION ARE THE LOW LEVEL OF DOMESTIC DEMAND, CITED BY 91 PERCENT OF RESPONDENTS AND EXPORT ORDERS

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CITED BY 42 PERCENT. IN THE CASE OF EXPORT ORDERS. IT SHOULD BE NOTED THAT THE NUMBER OF FIRMS CITING THIS AREA HAS DECLINED STEADILY FROM THE 58 PERCENT FIGURE IN APRIL.

A SIGN OF A POSSIBLE DECLINE IN UNEMPLOYMENT CAN BE SEEN IN THE SURVEY RESULTS ON LABOR REQUIREMENTS. TWENTY-FOUR PERCENT OF FIRMS EXPECT TO INCREASE THEIR LABOR FORCE OVER THE NEXT YEAR WHILE 21 PERCENT EXPECT TO REDUCE THEIR MANNING LEVELS. THIS IS THE FIRST TIME THAT THOSE EXPECTING TO INCREASE HIRING HAVE OUTNUMBERED THOSE STILL SHEDDING LABOR. THESE FIGURES ARE ROUGHLY IN LINE WITH THE CBI RESULTS.

TURNING TO WAGE COSTS AND OVERALL UNIT COSTS, THE ANTICIPATED RESULTS OF THE SECOND YEAR OF WAGE RESTRAINT BECAME APPARENT. FULLY 61 PERCENT OF FIRMS BELIEVE THEIR WAGE BILL WILL RISE BETWEEN 0 AND 9 PERCENT COMPARED WITH 42 PERCENT IN JUNE AND 20 PERCENT IN APRIL. HOWEVER, THE MEDIAN EXPECTATION ON UNIT COSTS FALLS IN THE 10-14 PERCENT RANGE REFLECTING HIGHER PRICES ON RAW MATERIALS.

COMBINING THEIR SALES AND COST EXPECTATIONS, 30 PER-

CENT OF RESPONDENTS EXPECT THEIR PROFIT MARGINS TO WIDEN OVER THE COMING YEARS: A FIGURE LITTLE CHANGED SINCE APRIL. MORE SIGNIFICANTLY, THE PERCENTAGE OF FIRMS EXPECTING THEIR PROFIT MARGINS TO CONTRACT HAS DROPPED FROM 34 PERCENT IN APRIL TO 14 PERCENT IN JULY. REFLECTING THE EXPECTED IMPROVEMENT IN PROFIT MARGINS, THE PERCENTAGE OF FIRMS EXPECTING EARNINGS TO RISE OVER THE NEXT YEAR (40 PERCENT) EXCEEDED THOSE EXPECTING A DECLINE (22 PERCENT). A SLIGHT IMPROVEMENT OVER THE JUNE SURVEY.

THE SURVEY RESULTS CONFIRM THE FACT THAT ECONOMIC RECOVERY IS WELL UNDER WAY. ANY DECLINE IN THE LEVEL OF OPTIMISM SHOULD BE ATTRIBUTED TO A SLOWING IN THE RATE OF CHANGE IN BUSINESS OPINION RATHER THAN THE EXPECTATION THAT ANOTHER CONTRACTION IS ABOUT TO BEGIN.

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FM AMEMBASSY LONDON

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INFO AMEMBASSY BERN

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6. EXCHANGE RATE AND GOLD

EFFECTIVE EXCHANGE DEPRECIATION				
DATE	RATE (\$)		PERCENT	GOLD
7/28	1 7095	38.3		\$112-7/8
7/29	1.7865	38.7		\$112.1/8

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7/30	1 7855	38.8		\$112-5/8
8/2	1.7885	38.8		\$111-7/8
8/3	1.7885	38.7		\$112-1/8

CHANGE 7/27-8/3 UP 0.0065 WIDENED 0.1 DN \$2.00

7. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
7/28	1 10	3.08	5.90
7/29	1.08	3.18	5.92
7/30	1.08	3.18	5.95
8/2	1.22	3 20	5.95
8/3	1 28	3.28	6.25

CHANGE 7/27-8/3 UP 0.13 UP 0.13 UP 0 35

(ALL FIGURES IN CENTS)

8. EURODOLLAR INTEREST RATES

DATE			
7/28	5-1/8	5-3/4	6-1/4
7/29	5-1/2	5-5/8	6-1/4
7/30	5-7/8	5-3/4	6-1/4
8/2	5-1/2	5-3/4	6-3/8
8/3	5-1/2	6	6-3/8

CHANGE 7/27-8/3 UP 1/4 UP 1/4 UNCHANGED

9. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
7/28	5-17/32
7/29	5-7/8
7/30	5-13/32
8/2	5-15/32
83	5-3/16

10. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
7/28	11-1/8	11-1/4	11-15/32
7/29	11-1/16	11-3/16	11-7/16
7/30	11-1/16	11-3/16	11-15/32
8/2	11	11-3/16	11-1/2
8/3	10-31/32	11-3/16	11-13/32

CHANGE 7/27-8/3 UP 5/32 DN 1/16 DN 3/32

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11. THE MINIMUM LENDING RATE REMAINED UNCHANGED AT 11-1/2 PERCENT ON TRIDAY, 7/30, AS THE TREASURY BILL RATE ROSE 0.0019 PERCENT TO 10.8693 PERCENT.

ARMSTRONG

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TAGS: ECON, UK
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